

Accounts Payable Audit Program



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How to Implement an Accounts Payable Audit Program

Internal controls play an important role in any business, helping to mitigate fraud, reduce human error, and ensure that established procedures and processes are followed.

Nowhere is this more important than the accounts payable department. Because of its proximity to business finances, it's important that any business, large or small, conducts an audit of its AP department annually and maintains good

internal controls for managing accounts payable.

And for some businesses it's a requirement.

For example, the Sarbanes-Oxley Act requires all public businesses to submit records yearly to a third party for an external audit. Private companies that apply for loans or credit must also have a routine audit performed, with these audits typically completed by a third-party auditing or CPA firm.

But even if not required, small and mid-size businesses should regularly audit business finances, particularly accounts payable. The best way to do this is to create an internal AP audit program. Auditing AP annually can also help spot potential trouble spots before they become a more serious issue.

What Is an Accounts Payable Audit Program?

An accounts payable audit program reviews AP transactions for compliance with established internal controls. Implementing an internal AP audit program sounds daunting, but it doesn't have to be.

The best way to create your program is to establish the parameters for the audit, what areas you wish to focus on, and how the results of the audit will be used.

Creating an official template for your audit process will help guide you through the process, serve as a reference point going forward, and will also be able to be used annually or whatever the frequency of your audits will be.

What Is the Purpose of an Audit Program?

Internal controls are important part of doing business, and there's no department where they matter more than in accounts payable. But even with internal controls in place, how will you know if they're being followed if you don't perform an audit?

In most cases, fraud and embezzlement originates in the accounts payable department. What other department allows you to set up a new vendor, enter a payment amount, and have accessibility to company check stock and bank

account information?

But it isn't just fraud that can cost your company. Duplicate payments can wreak havoc on business finances, and if that duplicate payment went to a vendor you don't regularly do business with, your chances of getting that money back are slim.

What to do Before You Begin an Internal Audit?

Before you begin a review of your AP process, you must have established policies and procedures in place for AP staff to follow. These controls can include the following and should always be in writing.

- All accounts payable department duties are clearly defined
- Responsibilities for each AP position have been established
- Related duties (approving invoices, processing payments, etc.) are clearly separated
- Procurement procedures are clearly defined
- Purchase order use and requirements are clearly defined
- New vendor process is clearly defined
- Any bidding requirements are clearly defined
- Three-way matching (invoice, purchase order, and shipping receipt) is required
- The invoice coding process is clearly defined
- The invoice approval process is clearly defined
- Check access and use of check stock is stated in writing

Once these policies and procedures have been established and made readily available to all AP personnel, you can begin to create auditing standards for your

audit program.

How Do You Audit Accounts Payable?

Jane owns First Place Distributors. In 2021, Jane decided to create an AP audit program for her business, using an internal controls checklist of each of the areas that she wished to examine regularly. Jane used Word to create her audit template for her first audit, completing the first page as follows.

AP Audit Program	
First Place Distributors	
Date of Audit: January 2, 2022	
Audit Period: 2021	
Audit Participants	
NAME	ROLE
Jane Turner	CEO
Sam Lopez	Accounting Manager
Angela Johnson	AR Manager

Once Jane creates this template cover sheet, she can use it each year, simply changing the date and the audit period. She can also update audit participants as needed. Notice that none of the AP team are included on the audit team.

As an audit looks at established internal controls, it's important that you create a checklist of items that you and your audit participants will be looking at. Some items on the checklist may require a separate work paper, which is used to substantiate any audit results.

Each work paper should be given an identifying number that you can reference on your checklist if further information or additional research is needed.

GENERAL CHECKLIST	Completed By	Workpaper #
Prepare a balance sheet for audit period		
Verify the beginning balance with the ending balance of the previous year		

Reconcile ending AP balance with the general ledger balance investigating any variances		
Recalculate AP vendor balances to compare with GL balance		
Review and investigate any unusual increases or decreases in balance		
Match aging report against vendor invoices		
Review vendor file for payable records		
Check open balances and contact vendors for verification of balance		
Follow up if the vendor does not respond		
Review disbursements of more than \$500 and review attached documentation		
Review one-time payments including supporting documentation		
Review year-end accruals and cutoff dates and match supporting documentation		

Accounts Payable Audit Checklist

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What Are the Key Objectives of an Accounts Payable Audit?

There is no one way to perform an audit, so you can determine the areas that are of the greatest importance and concentrate there.

Whether your audit is conducted internally or through a third party, there are key audit objectives that you should be concentrating on.

• **Completeness**

Checking for completeness is one of the most important objectives of an AP audit, which includes determining whether documents have been properly recorded in the correct period. This is done by reviewing and comparing AP payments to the payables total recorded in the GL, also examining the invoice for the proper documentation.

For example, an audit examination may focus on a payment in the amount of \$3,000, which appears as an anomaly because most AP payments are for less money. To verify completeness, an auditor will look at the entire payment process, including purchase date and when it was recorded.

Auditors will also match the payment to supporting documents such as an invoice, purchase order, and shipping receipt.

If there is no purchase order, or purchase order was not required, the auditor will look at who approved the invoice for payment.

• **Validity**

One of the best ways to identify fraudulent activity is to research the validity of certain AP transactions. These can be randomly chosen, or auditors can concentrate on a specific area such as a new vendor or payments over a set amount. Auditors may also ask vendors for verification of open invoice balances.

• **Compliance**

Whether you're a publicly held corporation or a small business with five employees, compliance is important. While Generally Accepted Accounting Principles or GAAP compliance isn't required for small, privately owned businesses, compliance standards should be set and maintained. compliance.

Accounts payable compliance starts with a review of all AP transactions, including a review a previous period's ending payable balance and the current period's beginning balance to be sure that they match.

The audit process should also include a review of financial statements and related documents such as the payable ledger and check register to identify any questionable balances or transactions.

• Disclosure

Disclosure determines whether your AP transactions have been properly disclosed. That means that your current AP balance should always match your GL balance.

This is determined by adding outstanding invoice totals and comparing that total against the AP total in your GL.

Key Objectives of an Accounts Payable Audit



Completeness



Validity



Compliance



Disclosure

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What Should be Included in an Audit Program?

An accounts payable audit should include the following four steps:

1. Planning

The planning stage is one of the most important steps. Before an audit can be completed, all relevant personnel should discuss desired outcomes. For example, if a CEO suspects AP fraud, they may request that the focus of the audit be on searching for fraud.

Likewise, if multiple errors are suspected, processes and procedures may be examined to ensure that they are being adhered to.

The audit can take any form that you like or feel is necessary, but before it can begin, expectations need to be set.

2. **The Audit**

Once expectations have been set, the audit is ready to begin. When choosing to conduct an internal audit, you'll need to carefully choose staff to conduct the audit. It's important that audit staff are not current AP team members.

Once the audit begins, the auditing team will review current AP procedures, speak with staff to discuss procedures followed, and ask for clarification on daily activities.

Part of the audit will also include reviewing financial statements, asking for additional details or backup documentation for AP transactions, and reviewing GL accounts against AP accounts to ensure they are in balance.

An audit also searches for unrecorded liabilities, and may also involve open balances verification.

3. **Audit Report**

After the audit is complete, the audit team members will review their findings and share them with the appropriate staff members in an audit report. Reporting may also include recommendations if problems or issues were found during the audit.

4. **Follow-Up**

Once you establish an internal AP audit program, you can easily review results from the prior year's audit to determine whether suggestions were followed or improvements made.

If this is your first internal audit, and significant issues were found, you may want to schedule a quick review to determine whether recommendations have been implemented as suggested.

Accounts Payable Audit Process



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What Controls Should an AP Audit Look At?

There are four sets of controls that auditors will examine.

1. Obligation to pay controls

Obligation to pay controls covers four areas in the payable process; purchase order approval, invoice approval, three-way matching, and duplicate payment search.

Reviewing these four controls is key for businesses looking for potential fraud, or just wanting to see if current procedures need to be improved.

If you currently use a purchase order system, you'll want to make sure that the P.O. is approved before an order is placed with a vendor.

For expenses that do not require a purchase order, auditors will check to see that the appropriate approval process has been followed.

Auditors will also check that a three-way matching system to prevent potential fraud, duplicate, or overpayments has been followed. The three-way matching system matches a purchase order to an invoice and a shipping receipt.

Duplicate search is also an important area for auditors to review. A duplicate search is used to determine that an invoice has only been paid once.

Though smaller businesses may be able to catch duplicate payments fairly easily, companies that process hundreds or thousands of invoices, or have multiple clerks entering invoices will not remember if a vendor or supplier has been paid.

2. **Data entry controls**

As alluded to earlier, there are two ways that you can choose to enter AP invoices. Recording an invoice prior to approval may be the preferred method for a company that uses a robust procure-to-pay software such as PLANERGY, with all purchase orders approved prior to ordering.

If you don't have a purchase order system in place, it's important that any invoice received is routed for approval prior to entering it into AP.

Whatever method you use in your business, or you may use a combination of the two, auditors will be looking to see that the appropriate approval methods have been followed.

3. **Payment controls**

When reviewing payment controls, auditors look at the following:

- **Segregation of duties** - At least two people should be involved in the AP process, with one person cutting checks or preparing electronic payments, and a second person signing the checks or approving the ACH transfer.
- **Check number sequence and storage** - Along with checking for missing checks or a gap in check numbers, auditors will also want to see how and where check stock is kept and if it's secure.
- **Check-signing requirements** - It's never a good idea to use a rubber stamp signature on checks, but it's not practical for someone to sign hundreds of checks weekly, which is why making

the move to an automated AP application and electronic payments, which eliminates the need to use checks at all.

4. Fraud Controls

Fraud controls are important, particularly when you're processing AP manually.

Making the switch to an automated AP system can automate many of the steps involved in the AP audit process, making it easier to complete an audit while helping to keep your business and your AP department free of fraud and other costly mistakes.

Accounts Payable Controls for Strong Compliance



Obligation to pay controls



Data entry controls



Payment controls



Fraud Controls

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Can You Automate an Accounts Payable Audit?

While the audit itself cannot be automated, automating the entire AP process from purchase order to payment with a complete audit trail readily available makes audits less stressful. This is because an automated AP system provides the following benefits:

- A clear audit trail
- Automatic flagging of suspicious activity
- Electronic storage of documents for easy accessibility
- Automatic document capture and classification to mitigate errors
- Security controls that limit system access

AP automation doesn't mean that fraud doesn't exist or that errors won't happen. But what it does offer is a better way to manage your AP department by reducing human error and significantly reducing the incidence of fraud.

An Internal AP Audit Program Protects You and Your Business

Taking the time to implement an internal audit program is time well spent.

While creating internal controls is an important first step, it's only one step, and means nothing if there are no checks and balances in place to make sure that those controls are being followed.

Whether your AP department is still processing payments manually, is transitioning to AP automation, or is already completely automated, you still need to know what's going on in your business, and there's no better way to do that than by creating the proper internal audit procedures when creating your own AP audit program.

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download a free copy of our guide

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